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SIPDIS

STATE FOR E, P, EUR/SE AND EB
TREASURY FOR U/S TAYLOR AND OASIA - MILLS
NSC FOR QUANRUD AND BRYZA

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SUBJECT: TURKISH ECONOMY MARCH 27: MARKETS QUIET;
FOREIGNERS OUT; TURKS SAY NO CONFIDENCE IN GOVERNMENT

Classified by Economic Counselor Scot Marciel for reasons 1.5
(b, d).

11. (SBU) Summary: While Turkish markets were relatively quiet on March 27 am, a wide range of market and GOT contacts tell us confidence in the government remains rock bottom. This translates into ongoing serious concerns about the GOT's ability to roll-over about \$3 billion of debt in its local T-bill market on April 8. Treasury's cash reserves at that date are likely to be about TL 1.8 quadrillion (\$1.1 billion). One new wrinkle to the April 8 roll-over problem is the large percentage of debt coming due which is held not by Turkish banks but by the Turkish public (as much as 40 percent.) Treasury is pressing the IMF to schedule a Board date for the Fourth Review before the April 9, but the GOT is not moving quickly to resolve pending issues. End Summary.

Markets Flat, Volumes Thin

12. (U) In morning trading March 27, yields on T-bills were unchanged at 64 percent compounded. CEO of Disbank (mid-sized Turkish bank) Bayazit told us banks were bringing down yields ahead of the Monday March 31 end of first quarter, when publicly traded banks report their balance sheets to the shareholders. After March 31, Bayazit expects yields to resume their upward trend ahead of the April 9 \$3 billion debt redemption. The lira was also unchanged at TL 1,710,000 to the dollar, and the Istanbul Stock Exchange closed up 0.7 percent.

BRSA Chairman: Capital Flight Limited, but
F/X Liquidity is a Problem

13. (SBU) Chairman of the Banking Regulatory and Supervision Agency (BRSA) Engin Akcakoca told EconCouns March 27 that market confidence in the Turkish government had never been lower (his full remarks will be in septel). On the banking sector, he said for the moment there are liquidity problems on the F/X side, but the Central Bank is stepping in to lower its short-term borrowing rates (which have dropped from 12 to 6 percent over past week), and to keep F/X lines open. Nevertheless, "if withdrawals continue, we'll be in crisis management mode."

-- Turkish bank customers are switching out of foreign exchange and into Turkish lira, rather than transferring capital out of the country. They are taking advantage of higher interest rates in the TL markets. Per BRSA data, Turkish banks report a total of \$1.8 billion in withdrawals of foreign currency deposits between March 14 and 25. In return, TL deposits have increased about TL 1 quadrillion and T-bill sales have increased about TL 1.5 quadrillion. Akcakoca estimates \$100-200 million of F/X cash was taken out of banking system and put under mattresses in this period.

Concerns with April 9 \$3 billion Debt Redemption

14. (SBU) General Manager of Kocbank (a mid-sized Turkish bank half-owned by Italy's Unito Credito) Kemal Kaya told us the banks remain concerned with the roll-over of the April 9 redemption. The wild card in the April 8 auctions, per Kaya, is the high percentage of the T-bills to be redeemed on April 9 which are owned by the Turkish public, not by the banks. He estimates the percentage in public hands to be about 40 percent. While Turkish banks will want to roll-over their T-bills, per Kaya, they do not want to buy more bills. No one can predict at present the public's appetite to roll-over the debt at the April 8 auctions.

15. (U) Kaya said he heard from the bankers who met at Treasury on March 26 that "Undersecretary Oztrak looks burned out. The rumor is his days are numbered. The bankers told Babacan that replacing Oztrak would be extremely negative for market confidence." (Note: Tuncay Ozilhan, Chairman of TUSIAD which is the prestige Turkish business group, gave a press statement March 26 reinforcing the point that now is not the time to replace the reform-minded top civil servants. Ozilhan also urged the GOT to move forward quickly with the IMF and also to extend the current Stand-by Arrangement until 2006.)

Treasury Concerned as Well, but
Still Negotiating LOI Terms

16. (C) Treasury Deputy U/S for public finance Hakan Ozyildiz told us that, in Treasury's March 26 meeting with the managers of the top four Turkish banks, the main message from the banks was "finish the IMF Fourth Review immediately." Ozyildiz said Treasury was pressing the IMF to sign the LOI tomorrow, and to schedule a Fourth Review Board meeting before the April 9 redemption.

-- IMF resrep told us there are still several issues to be resolved before the LOI can given to IMF senior management: for instance, the GOT has not yet canceled the pending investigations into BRSA's intervention of Pamukbank. If the issues were resolved overnight, IMF senior management could begin reviewing the LOI tomorrow and the LOI could be signed early next week.

-- On the April 8 auctions, Ozyildiz said the current plan is to target a 85 percent roll-over of the April 9 redemption (i.e. raise about TL 4 quadrillion or \$2.35 billion). His conservative projection of Treasury's cash balance ahead of the April 9 redemption is TL 1.8- 1.9 quadrillion. If the cash position is better than this projection (because tax collection is stronger than projected) then the April 8 borrowing needs would be somewhat less.

-- Ozyildiz said Treasury would work closely with the 10 primary dealers in TL-denominated debt (9 Turkish banks and HSBC) in offering appropriately short maturity debt on April 18. He has scheduled meetings in Istanbul and conference calls next week with these dealers.

Upheaval At the Privatization Administration:
Populist Fiddling

17. (U) The Prime Ministry announced March 26 that President Sezer had approved a change in ministerial portfolios, shifting the Privatization Administration (PA) away from Deputy PM Sener and into the portfolio of Finance Minister Unakitan. Last week, all three vice presidents at PA were replaced by AK Party cadre.

18. (SBU) On March 26, Deputy PM Sener gave a farewell speech on privatization asserting that the 2003 program was on track (septel has a privatization update). The markets, however, focused on his remarks that, "the parliament is working on a law to ensure nobody working in a state enterprise under the PA portfolio will suffer from unemployment." (Note: Sener unveiled this draft law in January; if passed, it would allow state enterprise workers to convert to the GOT civil service rather than face a lay-off. The World Bank believes few state enterprise workers would opt for lower paying civil service jobs, and would seek job severance packages instead. However, this law's populist signal to the markets is quite negative.)

19. (C) Comment: According to rumors in the market, Sener lost privatization because AK-associated businesses that had earlier won some smaller privatization tenders had complained to PM Erdogan that the PA was too aggressive in requiring them to pay up. Privatizations in Turkey are usually paid for by installment (which means there are often payment delays). If true, this is another example of the AK government focusing on the narrow interests of constituents and missing the bigger picture of a malfunctioning government.

110. (C) World Bank economist Parks gave us another example of populist fiddling on March 27. Industry Minister Ali Coskun this week instructed the agricultural sales cooperatives (part of his ministry) not to implement a decision to close down several loss-making cotton spinning

mills owned by the cooperatives. The World Bank requires this decision under one of its adjustment loan programs (Agricultural Sector Reform Loan). Such decisions hold up the cash flow to the Treasury at a time when cash reserves are desperately needed.

PEARSON